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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Report of the Ad Hoc Working Group on Comparative Experiences with Privatization on its fourth session

held at the Palais des Nations, Geneva,
from 5 to 8 April 1994

UNITED NATIONS

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Geneva

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New York and Geneva, 1994

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INTRODUCTION

1. In accordance with the UNCTAD calendar of meetings, the fourth session of the Ad Hoc Working Group on Comparative Experiences with Privatization was held at the Palais des Nations, Geneva, from 5 to 8 April 1994.

Opening statements

2. The Deputy to the Secretary-General of UNCTAD and Director-in-charge of the Division on Transnational Corporations and Investment welcomed participants to the fourth and final session of the Ad Hoc Working Group. In looking back over the achievements of the 16-month period since the Group had begun its very ambitious work programme, he considered that an impressive list of issues had been covered. These included: the role of the State, the objectives of privatization, the strategies and techniques of privatization, and such options as non-divestiture and divestiture, financial mechanisms, competition, privatization of infrastructure and social impacts and social-support measures. The current session would also address privatization of pension funds and environmental issues. The large number of country presentations transmitted to the Group was a clear indication of the strong interest shown by Governments in the work. The informal meetings had encouraged frank exchanges of experience, while panel-led discussions and the high level of expertise which all participants brought to bear on the debates meant that many difficult questions could be tackled. This candid approach had made it possible to gain useful insights into a wide range of privatization experience reflecting a variety of country situations. The process had allowed wide consensus to develop and converging perceptions to emerge on what constituted viable measures. In the process, factors that were critical to the design and implementation of privatization programmes were identified.

3. While such complex issues could be summarized only at the risk of over-simplification, a few broad conclusions could be attempted. First, privatization was not an end in itself; it was simply a means to an end. Secondly, privatization was essentially a political process, as it involved changing the role of the State. Thirdly, privatization had to be carried out as an economic exercise in a proper macroeconomic and legal context conducive to the development of a sound private sector and assuring maximum benefits from the sale of ownership rights. A firm commitment to private sector development was necessary and in this connection a host of issues had to be addressed. Fourthly, no two privatizations were alike. Fifthly, privatization required an efficient public sector, not to do what could be done better by the private sector or by the market but to do what they failed to do. Sixthly, privatization was a social process and social aspects had to be incorporated from the start. Finally, privatization implemented under favourable conditions could provide important benefits. There was evidence that it yielded efficiency gains in terms of better competition and lower prices.

4. The Ad Hoc Working Group had generated an impressive volume of useful documentation during its work. In addition to the 47 country presentations mentioned and the papers prepared by panellists, a cross-country review of

national experiences, a directory of national focal points, an annotated bibliography on privatization and a compilation of the contributions of international organizations regarding privatization had been prepared by the UNCTAD secretariat. Extensive summaries of the in-depth discussion and exchanges conducted by the Ad Hoc Working Group had been written up by the secretariat. These appeared in the reports of the previous sessions. Indicative elements for consideration in formulating privatization programmes had also been identified in an attempt to provide broad guidelines and policy options. Drawn essentially from the discussions of the Ad Hoc Working Group, these elements would need to be adapted to the specificity of each country's situation. Lastly, notwithstanding the considerable amount of work carried out, there remained some areas which were relatively unexplored. For example, private sector involvement in infrastructure provision, privatization of the financial sector and the role of privatization in stimulating both foreign investment and mobilizing domestic resources might be examined as these issues had significance especially for developing countries and countries in transition. With respect to these countries, the Ad Hoc Working Group might wish to give consideration to the question of measures by the donor community in support of privatization, including areas where technical cooperation might be strengthened and where recommendations, as appropriate, could be made.

Chapter I

CONSIDERATION OF THE COUNTRY PRESENTATIONS IN THE LIGHT OF A CROSS-COUNTRY REVIEW BY THE SECRETARIAT OF THE DESIGN, IMPLEMENTATION AND RESULTS OF THE PRIVATIZATION PROGRAMMES

(Agenda item 3)

5. For consideration of this item, the Ad Hoc Working Group had before it the following documentation:

"Design, implementation and results of privatization programmes: a cross-country review of national experiences", Report by the UNCTAD secretariat (TD/B/WG.3/7/Rev.2);

"Issues relating to (a) privatization and the environment and (b) the privatization of pension funds", Note by the UNCTAD secretariat (TD/B/WG.3/7/Rev.2/Add.1).

Country case studies by:

Colombia (TD/B/WG.3/Misc.5/Rev.1)

Germany (TD/B/WG.3/Misc.9/Adds.1 and 2)

Egypt (TD/B/WG.3/Misc.28/Add.1)

Fiji (TD/B/WG.3/Misc.40)

"Country presentations and statements",
China, Israel, Japan, Romania, Slovenia and the United Kingdom
(TD/B/WG.3/Misc.41)

Nepal (TD/B/WG.3/Misc.43)

Croatia (TD/B/WG.3/Misc.44)

Mexico (TD/B/WG.3/Misc.45)

Country statement

6. The representative of Egypt stated that the primary goal of Egyptian national policy on the environment was to achieve sustainable development. This was being pursued by: (a) establishing environmental standards and instruments of environmental regulation (law No. 4/94 had entered into force); (b) securing environmental quality adequate for the health and well-being of the population while conserving and using natural resources for the benefit of present and future generations; (c) raising public awareness and promoting understanding of the linkages between environment and development; (d) establishing guidelines and procedures for formulating environmental policies explicitly linked to early stages of the privatization process; and (e) cooperating in good faith with other

countries to achieve optimal use of transboundary natural resources and prevent or abate environmental pollution. Since the beginning of the 1980s, the policy of Egypt had been aimed at
protecting the environment in general. An inter-Ministerial environment unit had been established. In the early 1990s, radical improvements to the economic system were introduced, including a privatization programme in cooperation with the International Monetary Fund and the World Bank, aimed at improving the operation of existing public enterprises, introducing competition and opening the economy to the private sector. Law No. 203/1991 covered reorganization of public-sector entities. The environmental management of privatization was an important part of the privatization process and included the environmental record and liabilities of public enterprises.

7. At its 8th (opening) plenary meeting on 5 April 1994, the Ad Hoc Working Group decided to continue discussion of agenda item 3 in informal meetings (see annex I).

Chapter II

ELABORATION OF BASIC ELEMENTS FOR CONSIDERATION IN FORMULATING PRIVATIZATION PROGRAMMES AND PLANS

(Agenda item 4)

8. For consideration of this item the Ad Hoc Working Group had before it the following documentation:

"Indicative elements for consideration in formulating privatization programmes", Note by the UNCTAD secretariat (TD/B/WG.3/14).

9. At its 8th (opening) plenary meeting on 5 April 1994, the Ad Hoc Working Group decided to continue discussion of agenda item 4 in informal meetings.

10. At its 9th (closing) plenary meeting on 8 April 1994, the Ad Hoc Working Group decided to annex TD/B/WG.3/14 as amended to its Final Report to the Trade and Development Board (see also chapter III).

Chapter III

ADOPTION OF THE FINAL REPORT OF THE GROUP TO THE TRADE AND DEVELOPMENT BOARD

(Agenda item 6)

11. For consideration of this agenda item, the Ad Hoc Working Group had before it the following documentation:

"Draft final report of the Ad Hoc Working Group on Comparative Experience with Privatization", text submitted by the Chairman of the Ad Hoc Working Group (TD/B/WG.3/L.7).

Action by the Ad Hoc Working Group on agenda item 6 (the Final Report)

12. At its 9th (closing) meeting, on 8 April 1994, the Ad Hoc Working Group adopted its draft Final Report to the Trade and Development Board (TD/B/WG.3/L.7 and TD/B/WG.3/L.7/Amend.1), and authorized the Rapporteur to complete the final text as appropriate. At the same meeting it also decided to annex to that report the note by the secretariat setting out indicative elements for consideration in formulating privatization programmes (TD/B/WG.3/14), as amended by the Ad Hoc Working Group (TD/B/WG.3/L.9).

Chapter IV

STATEMENTS MADE AT THE CLOSING PLENARY

13. The representative of Ethiopia stated that, following the adoption of the Transitional Period Charter, the Transitional Government of Ethiopia had issued a new economic and investment policy enabling the people to participate equally in the overall economic activity of the country. The new economic policy was aimed mainly at: changing the role of the Government in the economy; promoting private investment; promoting public involvement in the development process; mobilizing external resources; involving national and regional administrative organs in the management of the economy; and preparing macroeconomic policies consistent with the new economic policy. In light of the above-mentioned objectives of the new economic policy, the Government was focusing on reducing the role of the State in the economy and encouraging private investors. Capital limits and price-control policies of the past dictatorial regime had been abolished. In order to enhance the privatization process, preparatory work was being undertaken. To this end, industrial public enterprises had been categorized into three main groups. Two groups would fully and partially undergo divestiture in the short- and medium-term, while the third group, comprising basic industrial public enterprises, would do so in the long run. The Council of Representatives of Ethiopia had recently issued a proclamation to establish a privatization agency with the main tasks of guiding and carrying out the privatization process, evaluating the enterprises and selecting their divestiture modalities. Together with the above-mentioned laws and regulations, the new economic policy was expected to cope with the developing socio-economic crisis and to stimulate recovery, growth and development.

14. Again famine threatened Ethiopia. It was not a result of mismanagement or a command economy, as had been the case during the past defunct regime, but rather owing to natural disasters and lack of sufficient material, financial and technical resources, notwithstanding the support offered by the international community. The full implementation of the economic reform required the relentless support of the developed world.

15. In closing, he thanked all the delegations that had shared their privatization experience and actively participated in the deliberations of the Ad Hoc Working Group. His delegation was confident that the conclusions and recommendations of the Ad Hoc Working Group, if fully and practically implemented, would benefit the developing countries and countries in transition.

16. The spokesmen for regional groups and country representatives expressed their thanks to the Chairman, Bureau, panellists and other delegations for their contributions and cooperation during the period of activities of the Ad Hoc Working Group. They also thanked the secretariat for its assistance in enhancing the output of the Ad Hoc Working Group.

17. The representative of Greece, speaking on behalf of the European Union and its member States, referred to the new realities of the globalization of the economy and the strengthening of competition. These new realities were the main rationale for the drive towards privatization. In this new context, the role of

States and of international organizations, along with a reincorporated private sector, was to be reinforced. It was to be hoped that a more efficient and fair system would emerge from these efforts.

18. The representative of the Russian Federation expressed his satisfaction that the Ad Hoc Working Group had paid attention to the needs and concerns of the countries in transition. These countries had embarked on a fast and far-reaching course of economic reforms in which privatization formed a key element. The Working Group had been very efficient in covering a vast volume of work while adhering to a very strict time-frame.

19. The spokeswoman for the African Group (Zambia) said that she was certain that all participants had gained a lot from the discussions of the Ad Hoc Working Group and would be able to return to their capitals and advise their respective Governments on the issues relevant to privatization.

20. The representative of China stated that the Working Group had given countries an opportunity to learn from each others's experiences and had provided a valuable forum in which to undertake in-depth investigation on key issues of privatization. His delegation had learned a great deal from the sharing of experiences with other countries.

Chapter V

ORGANIZATIONAL MATTERS

A. Opening of the session

21. The fourth session of the Ad Hoc Working Group was opened on 5 April 1994 by the Chairman, Mr. Bror Wahlroos (Finland).

B. Election of officers

(Agenda item 1)

22. At its 9th (closing) plenary meeting on 8 April 1994, the Ad Hoc Working Group elected Messrs. L. Gartner (Germany), P. Syryczynski (Poland) and A. Bhodcha-Oom (Thailand) to replace Mr. T. Janicki (Germany), Ms. U. Calka-Jendroszczyk (Poland) and Ms. P. Saranusit (Thailand) who were unable to attend. Accordingly, the bureau of the Ad Hoc Working Group at its fourth session was constituted as follows:

Chairman:	Mr. Bror Wahlroos	(Finland)
Vice-Chairmen:	Ms. Taos Feroukhi	(Algeria)
	Ms. Carmen Silva	(Colombia)
	Mr. Lutz Gartner	(Germany)
	Mr. Pietr Syryczynski	(Poland)
	Mr. Aarpon Bhodcha-Oom	(Thailand)
Rapporteur:	Mr. Herbert Dzvimbo	(Zimbabwe)

C. Adoption of the agenda and organization of work

(Agenda item 2)

23. At its 8th (opening) meeting, on 5 April 1994, the Working Group adopted the provisional agenda for the fourth session as approved by the Group at its third session and circulated by the secretariat in TD/B/WG.3/12 and Add.1). The agenda for the fourth session therefore reads as follows:

1. Election of officers

2. Adoption of the agenda and organization of work

3. Consideration of the country presentations in the light of a cross-country review by the secretariat of the design,

implementation and results of the privatization programmes 1/

4. Elaboration of basic elements for consideration in formulating privatization programmes and plans

5. Other business

6. Adoption of the report of the Ad Hoc Working Group to the Board.

D. Other business

(Agenda item 5)

24. There were no points raised under this agenda item in the course of the session.

E. Adoption of the report of the fourth session to the Board

25. At its closing plenary meeting on 8 April 1994, the Ad Hoc Working Group adopted the draft report of its fourth session (TD/B/WG.3/L.8) and authorized the Rapporteur to complete the text taking into account the proceedings of the closing plenary.

26. At the same meeting, the Ad Hoc Working Group decided to annex the summary of the main points made in the informal discussions on agenda item 3, concerning privatization and the environment and privatization of pension funds (annex I).

1/ Including the issue of the privatization of pension funds.

Annex I

MAIN POINTS MADE IN THE INFORMAL DISCUSSION ON AGENDA ITEM 3

Summary prepared by the UNCTAD secretariat

A. Privatization and the environment

1. General issues

1. Conceptually, there are five major links between privatization and the environment. First, the competitive pressures induced by privatization can lead to greater economic efficiency and thus to greater eco-efficiency. Secondly, privatization can induce the acquisition of modern technology and particularly of environmentally-sound technology. Thirdly, competition based on sound pricing principles will force enterprises to make efforts to be more efficient and to reduce waste. Fourthly, by clarifying property rights, the privatization process can create conditions for a better conservation of natural resources in a long-term perspective. Fifthly, and probably the most important element, is the redefinition of the role of the State in the areas of production and regulation, the latter being a critical factor in environmental protection. Privatization implies a shift from the role of the State as a producer to that of a regulator. Thus, problems in the design and enforcement of environmental laws, arising from the fact that the State is acting as both producer (the regulated) and judge (the regulator), can be avoided.

2. Empirically, there is no clear evidence that public enterprises pollute more than private enterprises. However, there may be a "circumstantial case" that privatization is beneficial to the environment for the following reasons. In the first place, public enterprises tend to use older and outdated technologies. The situation may be further exacerbated by the financial difficulties of the Government and budgetary constraints which limit the acquisition of modern technologies and equipment. In addition, public enterprises can evade more easily the enforcement mechanisms or the various penalties of non-compliance because of their special relationship with other state agencies. Furthermore, many public enterprises receive exemptions from the State which acts as both the owner and the regulator. Finally, the industries which benefit from a high level of protection tend to be more resource-intensive, and thus more polluting than private enterprises would be.

3. Conversely, privatization can also increase environmental degradation, because private enterprises tend to give higher priority to growth and profit maximization objectives, even at some environmental cost while comparable public enterprises may even choose to leave some productive capacities idle. Moreover, private enterprises can be in a better financial position to bribe regulators, particularly where they are poorly paid, in order to evade pollution controls. Finally, private enterprises are better able to hide information from the Government than public enterprises, thus making it harder for regulators to control them. In a high inflation situation, paying fines for environmental offenses is often preferred to redressing an environmentally undesirable situation. In certain cases, this problem has been solved by denominating fines in hard currency.

4. Overall, it is clear that ownership is not a determinant in terms of environmental damage. The solution to the problem lies in the government putting in place strong and sound environmental regulations and applying them equally to both public and private enterprises, as well as subjecting them to competitive pressures.

5. There are also various practical issues of great importance to the interrelationship between privatization and the environment. The most important is "internalizing the environmental costs", in order to achieve "full-cost" pricing. For example, in the energy sector, which is subject to detailed economic calculations because of privatization and also environmental and social concerns, there is now a trend to include explicitly in the economic calculations both environmental and social costs, such as those relating to the displacement of people. This new approach has helped, for example, to redefine perspectives on hydro-electric energy which had been extensively used in the past in Latin America because "cost advantages" failed to take into account social and environmental costs.

2. Policy issues

6. Governments pursue a number of policy objectives in addressing the relationship between privatization and the environment. These concern environmental regulation and protection, privatization and the promotion of economic growth. Privatization involves deregulation and the promotion of a competitive environment. Environmental protection, on the other hand, involves regulation. There is a need to balance and integrate them so that privatization and environmental policies form part of growth policies. In any case, Governments should have clear environmental policies in connection with growth policies.

7. It is important that environmental policies and instruments be properly integrated into privatization policies and that environmental impact assessments be undertaken especially in the area of infrastructure and environmentally sensitive sectors. Many public enterprises have significant potential environmental liabilities. These need to be addressed prior to privatization. Environmental impact assessments are a form of "internalization" of environmental externalities which may prove less costly than failure to anticipate and prevent potential environmental damage.

8. It is also important that they be integrated into growth policies. Where the growth and development patterns are likely to remain resource-intensive, it is important that the countries concerned not repeat the mistakes made by others in the past. A practical way to approach these issues is to subject economic operations such as privatization in environmentally sensitive sectors to environmental impact assessments conducted by the appropriate agencies in order to identify the actual and potential environmental liabilities and risks.

9. Where a sector is not contestable but suffers from structural deficiencies, the question may be raised as to whether it is advisable to delay privatization so that restructuring can be undertaken and the structural deficiencies removed in order to avoid possible irreversible damage to the environment.

10. It should be stressed that often the lack of institutional capacity or of political will to address environmental issues stems from the general lack of interest on the part of the public at large or a focus on other policy issues. In these circumstances, it is necessary to organize public awareness campaigns so as to sensitize the public to these issues. Successful campaigns have been launched in order to create public awareness of environmental issues in connection with privatization operations, particularly of public enterprises having major environmental importance.

3. Regulatory framework and market-based incentives

11. The issues of environmental cost definition and of environmental control require a strong legal and regulatory framework. The strengthening of the institutional capacity for the design and implementation of environmental policies and regulations is thus a matter of primary importance. There is evidence that developing countries are attaching increasing importance to environmental concerns; the establishment in these countries of specialized ministries and institutions to deal with environmental issues is one such manifestation. There is also evidence that in certain developing countries environmental concerns are being taken into account in the choice or selection of local and/or foreign investors. This is especially the case for industrial and agricultural projects submitted for privatization.

12. Regulatory instruments and rules should be of a general nature, so as to cover a maximum of possible effects on the environment. Moreover, they should be flexible enough to allow the private sector to carry out its obligations and thus participate in the economic reform programmes. Such regulation should also allow for cooperation with other governmental agencies and among industrial enterprises.

13. In order to determine the environmental cost of privatization projects, Governments need to establish what these costs are, who controls them and ultimately who assumes them. In some sectors, environmental costs might be too high to shift to private entrepreneurs, e.g. in the construction of roads where shifting such costs to the constructor would entail high costs for the consumer. In such cases, the State might have to assume partially or totally the environmental costs.

14. Most countries in transition in Eastern and Central Europe negotiate with prospective investors agreements on environmental risks and liabilities. The options available vary and include assumption of the risks by either the buyer or the seller or the sharing of risks between them. The sharing of such risks determines ultimately the sale price of the enterprise involved. In situations where the buyer and the seller assume the environmental risks, this is reflected in an agreement with conditional clauses governing the contested, assumed or unknown liabilities.

15. Apart from environmental regulation, there is also the important question of the transfer of environmentally sound technology through privatization, and of providing incentives to enterprises in order to take into account environmental

concerns. Incentive systems for different industry structures may also be envisaged.

16. In examining the privatization of specific enterprises, it was observed that competitive pressures as well as the possibility of establishing joint ventures with foreign partners had induced these enterprises to acquire environmentally sound technology. In some cases, the closure of firms which were not viable either economically or environmentally could lead to the emergence of new enterprises which were in a better position to conform to environmental standards and regulations. However, it was noted that in some developing countries the option of liquidating public enterprises would not necessarily result in the creation of new enterprises, and that other options of restructuring needed to be investigated.

4. Subjects for further consideration

17. One important subject for further study was the effectiveness of alternative enforcement systems under different kinds of ownership and market structures. Privatization often introduces fundamental changes in industry structures, the incentive systems of enterprises, as well as in the relationship between regulators and enterprise managers. Thus a "command and control" enforcement system may need to be adapted to the new ownership structure, or replaced with "market-based" instruments. Further research into the relative effectiveness of different enforcement systems within the framework of privatization would be instructive.

18. Another important area for further research was appropriate reforms in investment and trade regimes and land-use rights within the context of privatization. These policy areas had profound implications for resource utilization, investment in "dirty" or "clean" industries, and the import of environmental technologies, especially in economies where private ownership of production prevails.

B. Privatization of pension funds

19. The reform or privatization of pension funds is an issue directly affecting all sectors of society. It has long-term financial and social consequences. It is a complex problem that must be addressed within a specific country context, taking into account the employment situation, the level of development, the demographic evolution, the sophistication of the financial sector and other factors. It also touches upon the reform of the social security system. The nature and pace of reform are likewise complex issues. There is the question of the respective roles of state and private pensions, for example, whether the State should provide a basic pension, while encouraging participation in individually capitalized pension accounts. Such pension accounts may be state-administered or privately-managed. Further, there is the question of the time needed for a switch from a distributive or pay-as-you-go (PAYG), i.e. partially funded, defined-benefits system to an individually capitalized, i.e. fully-funded, defined-contributions system. In this connection, there is the issue of the transitional cost, while the two systems co-exist, and of how such a

cost is to be met. However fundamental the pension fund reforms may be, the State cannot completely disengage itself from the provision of social security and must retain at least a supervisory and regulatory role.

20. There is no perfect pension scheme. Each has its own potential shortcomings and risks owing to the long-term character and uncertainty associated with pensions. In judging the performance of pension schemes, it will be necessary to examine the levels of earnings, the inherent risks, the evolution of wages and other parameters.

21. In the final analysis, however, the fundamental problem which may endanger the financial balance of pension schemes and which cannot be addressed by the pension system itself is unemployment. Adequate levels of employment are thus necessary for the proper functioning of any pension scheme.

1. Shift to individually capitalized pension systems

22. The financial and actuarial pressures on PAYG systems - in some cases on the verge of collapsing - have prompted a shift in a number of countries towards individually capitalized accounts, providing a lump-sum or an annuity upon retirement. However, the shift has not involved a complete change-over in these countries, since some participants have opted, or still retain the option, to remain under the old system during the transitional period. In countries such as Chile, the new individually capitalized system has been operating alongside the old PAYG system for those workers who chose to remain with the latter. This has created significant strain in the financing of the PAYG pension system, which has been obliged to honour its commitments to its beneficiaries despite a dwindling flow of contributions.

23. The shift towards individually capitalized pension systems has occurred in response to low returns from the PAYG pension systems, owing to their obligatory investments in low-yield government bonds, the use of pension fund reserves to finance budgetary deficits and various political considerations influencing the structure and operational framework of such schemes.

24. A shift from a PAYG system to an individually capitalized system requires substantial preparation, including informing the population at large of the workings of the social security system. The process is sometimes adversely influenced by the short tenure in office of Ministers and directors of social security. In some cases, government authorities may therefore attempt to implement changes as fast as possible, regardless of their social impact.

25. The introduction of individually capitalized pension schemes is seen as an opportunity to reassess the fundamental financial and actuarial assumptions on which the national pension system is based and to put it back on a sound financial and actuarial footing. Therefore the transition to individually capitalized pension systems has often been accompanied by other changes, for example in raising the retirement age, as in Argentina.

26. The shift to individually capitalized pension systems raises a specific problem, namely the recognition of obligations by the former pension system. The

individually capitalized pension systems established in Argentina, for example, provide for a compensatory allowance on the basis of 1.5 per cent per year of contributions to the former system up to a maximum of 35 years, applied to the average earnings over the last 10 years. Other countries, such as Chile, have issued recognition bonds along similar lines.

2. Individually capitalized pension systems

27. Individually capitalized pension systems have a number of advantages. Pension funds are professionally managed; they have access to a greater diversity of investment instruments; they are more "portable". If well managed, they enjoy higher yields. They can also contribute to meeting the capital requirements of companies, the increased capitalization of financial markets, the increased mobilization of domestic savings and thus promote economic development. Furthermore, they provide the participants with more control over their pensions and are less threatened by demographic trends or budgetary pressures than PAYG schemes. They also address some of the major failings of the PAYG systems, including the declining contribution rates, as for example in Argentina. However, by comparison with PAYG systems, they lack the elements of mutual insurance or social solidarity and may have limited population and contingency coverage.

28. Individually capitalized systems are directly linked to the performance of their investment instruments and ultimately to the general performance of the economy. Their financial instruments are thus exposed to the volatility of financial markets.

29. Normally, the transfer by an individual employee from the PAYG system to the individually capitalized one is irreversible. In countries, where individually capitalized accounts have been introduced, account holders can change their pension account administrator, thus introducing an element of competition in the administration of the individually capitalized pension accounts.

3. Risks associated with individually capitalized pension systems

30. Individually capitalized pension systems pose risks for both contributors and the Government. The risks faced by the individual contributors include the investment risk, the contribution risk - relating to the inability of the contributors to pay contributions owing to illness or unemployment during their economically active life - and the conversion/efficiency risk, representing the fees charged by the pension fund administrator. High marketing and operating costs of the pension fund administrations constitute an important problem of individually capitalized pension funds.

31. Governments incur the costs of changing the pension fund system and run the risk of pension fund failures, if these are covered by government guarantees. In Chile, for example, minimum pensions (for those with a qualifying contributing period) are assured by the State.

32. The transitional costs can be financed from privatization proceeds, as in Argentina, or by issuing recognition bonds which have the effect of deferring the payment of liabilities, as in Chile. These costs may be put in the proper perspective when the population is alerted to the consequences of financial strains or instability faced by the PAYG pension system.

33. Although individually capitalized pension systems can increase the population coverage, as in Chile, where the new system has resulted in an increase in the rate of coverage from 50 to 60 per cent of the population, it should be recognized that the pension situation of low-income workers, persons employed in the informal sector and of the rural population has not substantially improved.

4. Economic effects of individually capitalized pension systems

34. By virtue of the substantial financial funds they administer, private pension funds have become major economic players in many countries. In Chile, the capitalized pension funds amount to US$ 17 billion, equalling 35 per cent of the national GDP. By the year 2000, these funds are expected to equal the national GDP. While they have helped to deepen domestic capital markets, they are under increasing pressure to find good investment opportunities, including those provided by the capital markets, in order to minimize investment risks and to assure an adequate real rate of return on their investments. Some recent legislation has been adopted enabling them to widen their investment portfolio and may help in this regard.

35. Moreover, pension funds have become major institutional investors, raising the issue of their influence on corporate governance. Through their substantial shareholdings, pension funds are in a position to influence the day-to-day running of companies, which may lead to conflicts of interest.

36. In the context of privatization, private pension funds have facilitated the implementation of privatization programmes by enabling sales to take place without crowding out other private sector demands in the capital markets and by contributing significantly to the capitalization of the privatized enterprises. By taking an important proportion of the shares of large-scale privatized enterprises, pension funds have also generated political support for the privatization process by showing that it did not benefit only large foreign corporations. However, the extent to which the capitalized pension funds have contributed to an increase in domestic savings remains to be assessed.

37. Some suggestions for further studies have been proposed, including the contribution of privatized pension funds to the implementation of privatization programmes; the role of the State in private pension fund systems; and the role of private pension funds in strengthening capital markets and mobilizing domestic savings.

Annex II

MEMBERSHIP AND ATTENDANCE a/

1. The following States members of UNCTAD, members of the Ad hoc Working Group, were represented at the session:

Algeria
Argentina
Bangladesh
Belgium
Chile
China
Colombia
Croatia
Cuba
Egypt
Finland
France
Germany
Greece
Honduras
Hungary
Indonesia
Italy
Jamaica
Japan
Libyan Arab Jamahiriya
Malaysia
Mexico
Morocco
Myanmar
Netherlands
Nigeria
Norway
Pakistan
Poland
Portugal
Republic of Korea
Romania
Russian Federation
Senegal
Slovakia
Sri Lanka
Switzerland
Thailand
Tunisia
Turkey
United Kingdom of Great Britain and Northern Ireland
United States of America
Zambia
Zimbabwe

2. The following other states members of UNCTAD, not members of the Ad hoc Working Group, were represented as observers at the session:

Afghanistan
Albania
Bulgaria
Ecuador
Eritrea
Ethiopia
India
Madagascar
Malta
Nepal
Philippines
Slovenia
Spain
Trinidad and Tobago
United Republic of Tanzania
Uruguay
Venezuela

3. The Economic Commission for Europe and the Economic and Social Commission for Asia and the Pacific were represented at the session. The International Trade Centre UNCTAD-GATT was also represented at the session.

a/ For the list of participants, see TD/B/WG.3/INF.4.

4. The following specialized and related agencies were represented at the session:

International Labour Organisation
World Health Organization
International Monetary Fund
United Nations Industrial Development Organization

The General Agreement on Tariffs and Trade was also represented at the session.

5. The following intergovernmental organizations were represented at the session:

European Free Trade Association
European Union
Organisation for Economic Co-operation and Development

6. The following non-governmental organizations were represented at the session:

General Category

Women's International League for Peace and Freedom
World Confederation of Labour
World Federation of United Nations Associations

Special Category

International Air Transport Association

7. The following panellists participated in the session:

Mr. Alejandro BONILLA GARCIA, ILO, Geneva
Mr. Heinrich BONNEBERG, Germany
Mr. Rafael HERZ, Colombia
Mr. Osvaldo MACIAS MUNOZ, Chile
Mr. S.I. NODLAND, Norway
Mr. Walter SCHULTHESS, Argentina
Mr. Carlos SOTO PEREZ, Mexico
Mr. James WADDELL, United States
Mr. H.R. ZAYYAD, Nigeria

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